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CHARLES F. MORE CROPLEY
CLERK

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1939.

Nos. **130 - 131**

WILLARD MANUFACTURING COMPANY,
Petitioner,

v.

J. E. KENNEDY, Former Collector,

and

WILLARD MANUFACTURING COMPANY,
Petitioner,

v.

ROBERT W. McCUEN, Collector.

PETITION FOR WRITS OF CERTIORARI TO THE CIRCUIT
COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITION FOR WRITS OF CERTIORARI
AND
BRIEF IN SUPPORT OF THE PETITION.

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v.

ROBERT W. McCUEN, COLLECTOR.

PETITION FOR WRITS OF CERTIORARI

TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable, the Chief Justice and the Associate Justices, of the Supreme Court of the United States:

Your petitioner, the Willard Manufacturing Company of St. Albans, Vermont, earnestly prays this Honorable Court for writs of certiorari to the United States Circuit Court of Appeals for the Second Circuit for a review of the judgments of that Court, in the above-entitled causes, which affirmed the judgments rendered against your petitioner, the plaintiff below, by the United States District Court for the District of Vermont.

OPINIONS BELOW.

The opinion of the District Court, which is unreported, consists of a "Decision of the Facts" (R. p. 28), a "Memorandum of Opinion on the Law" (R. p. 31), a "Judgment Order" (R. p. 33) and a "Decision *in re* Defendant's Exceptions" (R. p. 33), all of which were filed on September 16, 1938.

The opinion of the Circuit Court of Appeals (R. p. 229) was rendered on January 22, 1940, and is reported in 109 F. (2), 83.

JURISDICTION.

The cases arose under the Internal Revenue Laws and the jurisdiction of this Honorable Court is invoked under the Act of February 13, 1925, c. 229, Section 1; 43 Stat. 938; U. S. Code, Title 28, Section 347.

By an order dated April 18, 1940, and signed by Mr. Justice Stone, the time to file petition for certiorari was extended for a period of sixty days from April 22, 1940 and this petition, together with the record, was filed within that period.

THE STATUTES AND REGULATIONS INVOLVED.

The statutes and regulations involved, the pertinent parts of which are set forth in the appendix, are as follows:

1. *Revenue Act of 1918* (40 Stat. 1057-1060).
 - (1) *Section 203.*
2. *Regulations 45* (1920 Edition).
 - (1) *Article 1582.*
 - (2) *Article 1584.*

STATEMENT OF THE CASE.

The suits were brought simultaneously, the one against J. E. Kennedy, as former collector, and the other, against his successor, Robert W. McCuen, who was still in office, as Collector of Internal Revenue for the District of Vermont, on August 28, 1929 when the writs were issued (R. pp. 3, 7).

The taxes involved are the Federal income and profit taxes for the petitioner's fiscal or "taxable year" ending August 31, 1920. The total amount sued for is \$12,116.76 of which \$9,793.71 was paid to the defendant Kennedy in installments during 1921 and \$2,323.05 was paid to the defendant McCuen on September 8, 1926 (R. p. 39).

Since only one taxable year is involved, the two cases were consolidated and heard together by the District Court, sitting without a jury, on September 14, 15 and 16, 1932 and were decided together by that Court six years later on September 16, 1938.

The whole controversy revolves around the valuation which the Commissioner of Internal Revenue put upon the petitioner's inventory of cotton goods in making his final determination of the petitioner's tax liability for its taxable year ending August 31, 1920. The two specific questions as presented to the Circuit Court of Appeals are as follows:

THE QUESTIONS INVOLVED.

FIRST: *Was the Appellant authorized or permitted under the applicable statutes and regulations to report its inventory of cotton goods, as of August 31, 1920, on the basis of "cost or market, whichever is lower"?*

SECOND: *Was the value of the appellant's cotton goods inventory as of August 31, 1920, when taken on the basis of "cost of market, whichever is lower", \$167,609.69 as determined by the Commissioner of Internal Revenue and sus-*

tained by the judgment of the District Court, or, \$135,-209.16 as claimed by the appellant?

The District Court made a special finding and ruling sustaining the plaintiff, petitioner herein, with respect to the first question (R. p. 33) but decided the cases against the plaintiff on the second question (R. pp. 28, 31).

The Circuit Court of Appeals found and ruled against the appellant, the petitioner, herein, on both of the questions, but:

1. As to the first question the opinion of the Circuit Court of Appeals (R. pp. 232-233) states:

“But even if we were in error in this conclusion the appellant could not prevail unless we should overrule the Court’s findings as to market conditions existing at August 31, 1920.”

2. As to the second question the opinion of the Circuit Court of Appeals (R. p. 234) states:

“Therefore, the Court’s findings must be sustained, even though the case was so close that had there been a finding to the contrary of the one made, we might have been unwilling to upset it.”

While the cases may not seem to present any questions of fact or of law (1) which are entirely new in their nature or (2) which appear to be of great public interest and concern, we nevertheless earnestly believe, and, therefore, respectfully submit to this Honorable Court that there are special, important and just reasons why this petition for certiorari should be granted, among which are the following:

GROUNDS FOR THE ALLOWANCE OF THE PETITIONS FOR
CERTIORARI.

1. The opinion of the Circuit Court of Appeals clearly reveals that the Court itself felt grave doubts as to the correctness of its own conclusions with respect to both questions, thus so far departing from the accepted and usual course of appellate proceedings as to call for the exercise of this Court's power of supervision.

2. The Circuit Court of Appeals erred in overruling the District Court on the first question because the findings and rulings of the District Court on that question are clearly sustained by the evidence adduced at the trial and by the Commissioner's regulations promulgated under the statute pertaining to the valuation of inventories.

3. The Circuit Court of Appeals erred in its interpretation of *Article 1582 of Regulations 45*, as applied to the facts and circumstances of the instant cases, since that Court seems to have attached greater weight to mere form than to the real substance and purpose of the regulation.

4. Both the District Court and the Circuit Court of Appeals erred in their findings of fact with respect to market conditions existing at August 31, 1920, which is the gist of the second question, since (1) neither of the decisions is supported by any substantial evidence and (2) both of them are directly in conflict with decisions of the Court of Claims and the Board of Tax Appeals with respect to market conditions as they existed on that date.

5. The Circuit Court of Appeals erred in that its decision on the second question seems to rest solely on the case of *Elder Manufacturing Company v. United States*, 10 Fed. Supp. 125, but that case is clearly not in point because the inventory date in that case was April 30, 1920 when the cotton trade was booming and cotton prices were high, while in the cases at bar the inventory date is August 31,

1920 when there had occurred a great drop in the prices of cotton goods and an almost complete collapse in the cotton trade in general.

CONCLUSION.

WHEREFORE it is earnestly prayed that this petition may be granted to the end that the judgment of the Circuit Court of Appeals for the Second Circuit may be reviewed by this Honorable Court and that your petitioner may have such other and further relief as the ends of justice may require.

Respectfully submitted,

O. WALKER TAYLOR,
Attorney for Petitioner.





BRIEF IN SUPPORT OF THE PETITION.

PRELIMINARY STATEMENT.

All of the detailed facts with respect to the petitioner, the nature of its business, the filing of the returns and the claim for refund are fully set forth in the record (R. pp. 13-16) and it seems unnecessary to set them out herein.

As to the record itself, we beg to explain that we think that it is entirely too voluminous. This was brought about by the insistence of counsel for the Government, as appellee below, that the testimony of all of the witnesses be printed in question and answer form. In the event of the granting of the petition for certiorari, it is hoped that the record may be greatly diminished.

ARGUMENT.

As to the five reasons stated as grounds for the allowance of the petition for certiorari the following comments, arguments and authorities are respectfully submitted:

THE FIRST GROUND.

It is obvious from the opinion of the District Court as well as that of the Circuit Court of Appeals that the plaintiff, the petitioner herein has an honest and meritorious case and that both of the Courts below entertained grave doubts as to the correctness of their decisions. This is clearly established by the fact (1) that the District Court delayed its decision for six years after the trial and (2) that the Circuit Court of Appeals clearly expressed its doubts in its own opinion.

It is well established that all doubts in cases involving taxes should be construed strictly against the Government and in favor of the taxpayer.

Gould v. Gould, 245 U.S. 151; 38 S. Ct. 53.

United States v. Merriam, 263 U.S. 179; 44 S. Ct. 69.

Shwab v. Doyle, 258 U.S. 529; 42 S. Ct. 391.

The rule with respect to such doubts was clearly stated by Mr. Justice McKenna in the case of *Shwab v. Doyle*, *supra*, where he said:

“But, granting the contention of the defendant has plausibility, it is to be remembered that we are dealing with a tax measure, and whatever doubts exist must be resolved against it.”

In this respect we think it is clear that the decisions of the Courts below are directly in conflict with the decisions of this Honorable Court.

THE SECOND GROUND.

It is clear that the Circuit Court of Appeals erred in holding that the plaintiff's inventory was not properly made on the basis of cost or market whichever is lower and in overruling the decision of the District Court on that question (1) because there is no evidence to support such a finding by that Court and also (2) because the regulations of the Commissioner of Internal Revenue permitted the adoption of the basis of cost or market in 1920 regardless of the past practice of taxpayers.

The District Court found and ruled (R. p. 33) as follows:

“The decision is that the plaintiff inventoried its merchandise August 31, 1920, ‘at cost or market, whichever was lower’, . . . as it had done in prior years.”

We respectfully submit that this decision of the District Court is strongly supported by the evidence and clearly sustained by the regulation and the authorities. As to the evidence (1) an officer of the Willard Manufacturing Company

(R. p. 43, (2) a certified public accountant (R. p. 79) and (3) the Revenue Agent who examined the petitioner's 1920 return and the claim for refund upon which these suits are based (R. p. 60) all testified that the plaintiff's inventory was in fact taken on the basis of cost or market whichever is lower. The report of the Revenue Agent (R. p. 61) states as follows:

"A complete Revenue Agents Report was submitted under date of May 21, 1925, covering the years ended August 31, 1920 and 1921. The claim referred to above covers the fiscal year ended August 31, 1920, and contends that the closing inventory for this year should be reduced in the amount of \$31,060.44 because of a reduction in price during September of 1920.

"It appears from a thorough investigation of the prices used by this taxpayer in the original closing inventory that the basis used of cost or market, whichever was lower, was correct." (Italics supplied.)

It is true as stated in the opinion of the Circuit Court that in its 1920 return, the word cost was written in the space provided for a statement of the basis on which the return was filed. But, the testimony of the witnesses above referred to and the other documentary evidence clearly showed that the word cost was written on the return by the President of the Company who had not actually made up the inventory. Moreover, the plaintiff clearly showed to the District Court by the witnesses and by the items themselves that it was the practice of the company to use the "cost or market, whichever is lower" basis. Many of the items are shown on the return below "cost". The total value of the inventory as shown on the return is \$167,609.69 but the evidence (Plaintiff's Exhibit 13) shows that the total cost was \$173,174.51. If, as the Circuit Court of Appeals holds, the inventory was actually made on the basis of "cost", the Com-

missioner of Internal Revenue would then have determined the value to be \$173,174.51.

It is thus apparent that the petitioner never changed the basis of reporting its inventory. Even if it had it would have been entitled to do so for the year 1920 under the special provisions of *Article 1582 of Regulations 45* (p. 24, *infra*) which specifically provides that "a taxpayer may, regardless of its past practice, adopt the basis of cost or market, whichever is lower for its 1920 inventory".

In the case of *Howard Company v. Commissioner of Internal Revenue*, 15 B. T. A. 1096, in which the Commissioner acquiesced, the taxpayer had actually made its inventory for a fiscal year ending in 1920 on the basis of "cost" and had so stated in its return for that year. After *Article 1582 of Regulations 45* was amended as above indicated, that company changed the basis and reported its inventory on the basis of "cost or market, whichever is lower". The Commissioner of Internal Revenue held that the company was precluded from changing because it had not so indicated on its original return. An appeal was taken to the United States Board of Tax Appeals and in the course of the opinion the Board said:

"As we understood the situation, there is no controversy save as to the timeliness of the adoption by the petitioner of the 'cost or market, whichever is lower' basis. That is, the Commissioner does not question that the regulation in question would be applicable to a fiscal year taxpayer, situated as the petitioner, where a drop in market prices had occurred prior to the close of its fiscal year ending in 1920, as well as to one on a calendar year basis for 1920, nor is it questioned that had the change been timely made, income would have been properly determined by using the inventories as submitted by the petitioner on the 'cost or market,

whichever is lower' basis. Our only question then is whether the petitioner is to be denied the right to adopt a new basis for pricing its inventories because it was late in seeking to make the change.

.

"There can be little question that this petitioner is not foreclosed from the benefit of the foregoing provision because it did not make the change on its return when filed for the reason that the Treasury Decision which amended an existing regulation and gave authority for the change *was not promulgated until several months after the return was filed.*" (Italics supplied.)

In the cases at bar the Commissioner of Internal Revenue never raised any question (1) as to the petitioner's right to report its inventory on the basis of cost or market, whichever is lower, or (2) as to the fact that the inventory was intended to be so reported in 1920 as well as in other years, although he made the usual examination of the return and fully considered and rejected the claim for refund on entirely different grounds. The question was first raised by counsel for the government when the case came on for trial in the District Court.

In the case of *Peck & Hills Furniture Company v. Commissioner of Internal Revenue*, 16 B. T. A. 1008 in which the Commissioner also acquiesced, the taxpayer kept its books of account on the fiscal basis and its taxable year ended June 30, 1920 and actually reported its inventory on the basis of "cost" on its 1920 return. The Board held that regardless of that fact and the past practice, that company was entitled to have its inventory valued on the basis of "cost or market, whichever is lower".

The truth of the matter is that this regulation permitting taxpayers to adopt the cost or market basis for its taxable year 1920 was not promulgated until after the petitioner's

return for its taxable year 1920 had already been filed. In the very nature of things, therefore, it could not be expected to state on its return that its inventory was reported on that basis, and yet, in its opinion the Circuit Court of Appeals said:

“In its 1920 return the appellant stated that its inventory was based on ‘cost’. . . . There is no evidence that it ever obtained permission from the Commissioner to change the basis of its 1920 return; or that it ever attempted to change until it filed its claim for refund in December, 1926. . . .”

THE THIRD GROUND.

It is clear from the evidence, from the cases cited above and from many other similar cases which might be cited, that the Circuit Court of Appeals erred in its interpretation of *Article 1582 of Regulations 45* as applied to the facts and circumstances of the instant cases in that it attached greater weight to “mere form” than to the real substance of the matter and entirely disregarded the fact that *Article 1582 of Regulation 45* is in its nature “relief legislation” which should be construed most liberally in favor of the taxpayer.

Treasury Decision 3108 which was later embodied in *Regulations 45* as *Article 1582* which permitted a taxpayer to adopt the basis of “cost or market whichever is lower” for his 1920 inventory was not promulgated until after the Willard Manufacturing Company had filed its 1920 return. Regardless of this fact, the Circuit Court of Appeals held that the taxpayer should not be allowed to adopt that basis merely because it did not so state on the return. It was never necessary for the petitioner to get permission of the Commissioner to change the basis of reporting its inventory because both the Revenue Agent and the District Court found as a fact that the inventory had always been reported

on the basis of "cost or market whichever is lower". In this respect we think the Circuit Court of Appeals not only misconceived the purpose and intent of the regulation but construed this relief provision strictly against the taxpayer.

In the case of *Tucker v. Alexander*, 275 U.S. 228; 48 S. Ct. 45, Mr. Justice Stone said:

"The statute and the regulations must be read in the light of their purpose. They are devised, not as traps for the unwary, but for the convenience of government officials in passing upon claims for refund and in preparing for trial. Failure to observe them does not necessarily preclude recovery. If compliance is insisted upon, dismissal of the suit may be followed by a new claim for refund and another suit within the period of limitations. If the Commissioner is not deceived or misled by the failure to describe accurately the claim, as obviously he was not here, it may be more convenient for the government and decidedly in the interest of an orderly administrative procedure that the claim should be disposed of upon its merits on a first trial without imposing upon government and taxpayer the necessity of further legal proceedings. . . ."

THE FOURTH GROUND.

The fourth ground or reason for the allowance of the petition for certiorari is that both the District Court and the Circuit Court of Appeals erred in their findings of fact with respect to the market conditions existing in the cotton industry on August 31, 1920. The findings of the District Court in this respect as made on September 16, 1938 are directly in conflict with the findings which the Court made during the progress of the trial on September 15, 1932.

In its "Decision of the Facts" (R. p. 30) the District Court found as follows:

"On August 31st, the prices instead of being nominal were real and actual. . . . Still there was an 'open market' for such cloths in substantial volume and the quotations were not 'nominal due to stagnant market conditions', for divers small quantities were traded in daily at 'current bid prices' in the volume usually 'purchased by this taxpayer'. The market was merely inactive instead of active for purchasers were expecting materially lower prices."

As contrasted with the foregoing findings, the District Court during the course of the trial while the evidence was being offered and all of the witnesses were present, found, ruled or commented as follows:

"There has been a big drop in regard to the market. The market for finished goods was abnormal. They were trying to hold the prices up. . . . The market price was the price at which a willing purchaser was willing to buy, and a willing seller willing to sell. There were not many willing purchasers on August 31st, and the man says he lost his trade and could not do any business. Then the market would not be normal. Then they hold the prices up a long while, to October 1st or October 15th, but the market would not be there. That would be a fictitious market because the drop had occurred. There is no way that can be gotten away from, no matter how many witnesses testify. That is the law of supply and demand, and it has held good through all the ages. Prior to this time (August 31, 1920) there has been evidence to show the drop, and you have a big job on your hands to convince me that there was a normal market for these goods without reducing prices. You have an awful job on your hands if you expect to do that. It certainly is not a question of what ought to be the market. What

was the true condition of the market on August 31st has to be found out and taken into consideration including all the factors one of which is the crop . . . He may have carried on, hoping against hope that it would come up again. That he did not mark down his price until September is not the true test of what the market value was on August 31st."

The Circuit Court of Appeals seems entirely to have disregarded these earlier findings of the District Court on this point, for as pointed out above, it does state that "the case was so close that had there been a finding to the contrary of the one made, we might have been unwilling to upset it".

We respectfully submit to this Honorable Court that there was abundant evidence adduced at the trial to support "a finding to the contrary of the one made" by the District Court, and that neither of the decisions of the lower Courts is supported by any substantial evidence.

Mr. Lester T. Redman, of Lawrence and Company, a witness for the plaintiff, whose qualifications as an expert on market values of cotton goods was not and cannot be impeached, testified in substance (R. pp. 95, 96) as follows:

"In view of the condition with a falling market and a price list which was reduced on September 30th from the May list by 10 cents, and August 31st coming only a month prior to the new price list, I should say that the price list of September 30th more nearly represented the value of the goods than the price list of May 13th, . . . From June, 1920, until June of the following year, there was a very drastic drop. This whole period of the duration of the war was what I would call an abnormal market. One of the cloths in question, which is on the inventory and which was priced in May, 1920 at 43½ cents . . . went down from 43½ to 17½ cents,

and such fluctuation in that class of goods is something that is entirely unknown in the trade," . . .

Mr. Lacy H. Sellers, the Secretary of the Cone Export and Commissions Company of Greensboro, North Carolina, a witness for the Government, in his deposition (R. p. 183) testified in substance in regard to the leading cotton fabric dealt in by his company as follows:

"That his firm named a price in June, 1920 of forty-four cents on number 26-220 for August, September and October shipment and on that basis the production of the mills had to be allotted. The question of when the break came in regard to the fabric denim, representing a large part of his business, is rather difficult to answer because after the offering of June 21, 1920 and after selling up the mills production at that price covering the shipments to be made up through October, they withdrew from the market. Beginning along in the early fall months of that year these orders commenced to look undesirable to the purchasers and the market commenced to weaken from that point and as he recalls the next price they named when they offered the denim again for sale was on the basis of 25 cents. The decline in the market commenced to be more pronounced along in August or early in September."

Mr. Robert D. Vanderbilt, a witness for the Government, in his deposition (R. pp. 209-211) testified substantially as follows:

"Our records were such that on the date of August 31st there was nothing to indicate the existence of a definite market value for the goods. That was a period of marked fluctuation in values and, to protect the interest of our mills, our goods were held for some time without a price."

“Whether or not there were actual sales made on or around that date, we have no records to disclose. Our records, upon examination, did indicate that goods were billed at or around this date. They were billed at varying prices. That, coupled with my recollection of the conduct of our business during that period, makes me feel certain that we resorted at that time to what is called ‘at value’ selling.

“It varied with different goods, but generally speaking most of our goods throughout the entire house were put ‘at value’ about the middle of August, 1920.”

All of the foregoing evidence as to market conditions as given by the experts, is directly in line with a mass of documentary evidence which was offered at the trial.

The Year Book of the National Association of Cotton Manufacturers (Plaintiff's Exhibit No. 12, pp. 7 and 8) describes the abnormal conditions prevailing in the cotton cloth market during the middle and latter part of 1920 in the following language:

“Were it possible for cotton merchants to look back upon their experiences during the year 1920 quite dispassionately and disinterestedly, it is safe to say that they would find them dramatic to an extent scarcely paralleled in all commercial history. In particular, the contrast presented by the conditions existing in the cotton trade in the early part of the year, as against those with which merchants had to contend as the year drew towards its close, is one of the most violent of which we have any record.

“From the point of view of those actually engaged in the cotton business, however, the decline of nearly 70 per cent. in the general price of the commodity which

came about from July to December, 1920, though naturally it gave rise to some problems of a more or less difficult character, was much less a cause of anxiety and loss than were the quite unprecedented alterations of the relative values of the various qualities and grades of cotton which occurred simultaneously with the general downward movement of the price."

This unusual, abnormal and chaotic condition in the cotton goods industry during the year 1920 has given rise to much tax litigation involving the valuation of cotton inventories in that year but no other court or judicial body has ever made any such findings with respect to those conditions as were made by the District Court and the Circuit Court of Appeals in the cases at bar.

In the case of *Bedford Mills v. United States*, 59 F. (2d) 263, which involved the valuation of a cotton goods inventory as of June 30, 1920, the end of that company's taxable year, the Court of Claims made special findings of fact as to the market conditions as follows:

"13. The year 1920 witnessed a chaotic situation in the cotton goods industry. The prices of cotton goods had begun to advance in the early spring of 1919, and that advance had continued steadily and rapidly throughout the remainder of the year 1919 and until March and the forepart of April, 1920 when the prices attained were the highest reached since the Civil War. The mills were producing goods to the full extent of their capacities, and the demand for cotton fabrics greatly exceeded available supplies. The rise in prices was arrested in the latter part of April following the financial troubles in Japan with the attendant disruption and disorganization of the silk industry. The market at that time became dull. During the month of

May the cotton goods business slowed up very perceptibly, and on a comparatively dull market, prices began to weaken. The plaintiff's particular field in the cotton goods industry was adversely affected by the changing conditions, which in June were marked by declining prices, the curtailing of production by mills, the cancellation of orders, and return of merchandise by customers, and by their endeavors to reduce their stocks through resale of their merchandise, thereby weakening the market price therefor."

In the case of *Franklin Mills v. Commissioner*, 7 B. T. A. 1290 in which the Commissioner acquiesced, the question was the value of that company's cotton goods inventory as of August 31, 1920, the same as in the cases at bar. The Board of Tax Appeals held that because of the abnormal conditions existing at that date, the company should be allowed a period of sixty days before or after the close of its fiscal year in order to determine the true taxable value of its inventory. In the course of the opinion the Board said:

"The third issue presents the principal item in this proceeding and involves the inventory of petitioner of finished goods as of August 31, 1920. There can be no question that the market at the end of the fiscal year, for the goods in question, was most abnormal. Sales were infrequent; contracts of purchase were being freely cancelled. It is admitted by counsel for the respective parties, that the market for finished goods obtaining on August 31, 1920, should not be arbitrarily taken. . . . The sale by petitioner of one-half of its finished goods, *within sixty days before and following the close of its fiscal year*, represents to us a reasonable period for determining the market for the finished goods, and it follows that petitioner's inventory of

finished goods should be valued at the market thus established, . . .” (*Italics supplied.*)

It is clear from all of the evidence and the authorities that during the last half of the year 1920 most of the sales of cotton goods which were made were on the basis of “at value”. With this in mind, Mr. Redman, the witness for the plaintiff, was questioned and answered (R. p. 103) as follows:

“Q. If you had sold goods such as the Willard Manufacturing Company had in any part of August, or up to September 30th, at value, what price would you have charged . . . having in mind that the schedule made in the spring was maintained until September 30th?

“A. If we sold the Willard Manufacturing Company goods at value and did not make a new price until September 30th, we would have charged them the later price. That is instead of 65 cents, which was the price, we would have charged them 49½ cents which was the price that came out September 30th.”

All of the foregoing evidence, together with much other evidence of the same character which appears in the record, was offered to show that by reason of the market conditions existing in the cotton industry on August 31, 1920 this case comes squarely within the provisions of *Article 1584 of Regulations 45* (p. 25, *infra*) which among other things states as follows:

“Where no open market quotations are available, the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available such as specific transactions in reasonable volume entered into in good faith, or compensation paid for cancellation of contracts for purchase commitments. Where, owing to abnormal conditions, the taxpayer has

regularly sold such merchandise at prices lower than the current bid price as above defined, the inventory may be valued at such prices, and the correctness of such prices will be determined by reference to the actual sales of the taxpayer for a reasonable period before and after the date of the inventory."

It is respectfully submitted, therefore, (1) that both the District Court and the Circuit Court of Appeals erred in their interpretation of *Article 1584 of Regulations 45, supra*, as applied to the facts and circumstances of the cases, (2) that the findings of neither the District Court nor of the Circuit Court of Appeals with respect to market values or market conditions existing on August 31, 1920 is supported by any substantial evidence and (3) that the decisions of both of those Courts are directly in conflict with the findings and rulings of other Courts and the United States Board of Tax Appeals with respect to market conditions existing in the cotton industry on August 31, 1920.

THE FIFTH GROUND.

The case of *Elder Manufacturing Company v. United States*, 10 Fed. Supp. 125 which is the sole authority cited in the opinion of the Circuit Court of Appeals as a basis of its decision is clearly not in point because the inventory date in that case was April 30, 1920 when conditions in the cotton trade were normal whereas in the cases at bar the inventory date is August 31, 1920 when conditions were abnormal and there had occurred a great drop in the prices of raw cotton and all kinds and grades of cotton fabrics. That case was decided on March 4, 1935 when the cases at bar were still undecided by the District Court. In applying regulations 1582 and 1584 to the inventory date April 30, 1920 the Court in that case said:

"The term 'market' used in the statute and the regu-

lations in the phrase 'cost or market, whichever is lower', means the market price which plaintiff would have to pay for the merchandise in the inventory on the inventory date and not the price at which he sells such merchandise or offers its for sale."

The meaning of the term "market" as thus stated by the Court of Claims is sound and pertinent in so far as the inventory date of April 30, 1920 is concerned or at any other date where conditions in the trade are normal. We respectfully submit, however, that this decision is not a sound authority and guide in the cases at bar where the inventory date is August 31, 1920 when the conditions were so chaotic and abnormal. The evidence clearly shows that under the conditions prevailing on August 31, 1920 the plaintiff could have gone into the market and replaced its entire cotton inventory on the basis of "at value prices" which would mean the prices shown on the jobbers' September 30 price list instead of those shown on their price list made up in April and May. Even though the lists were not changed until September 30, 1920 the cotton goods which the plaintiff had on hand were not worth the April and May prices for which the government contends because as pointed out by the District Court (R. p. 29) "the market price for raw cotton had declined 26% between May 1 and August 31, 1920 and the price of grey cloth had declined during that time 39%". Thus, on August 31, 1920, the petitioner could have replaced its entire inventory, or purchased the equivalent, on the basis of "at value" prices which would be \$135,209.16, as shown on the September price lists, instead of \$167,609.69, as shown on the price lists which had been made up in April and May, 1920.

CONCLUSION.

In conclusion we respectfully request this Honorable Court, in passing upon the petition for certiorari to consider the equity of the whole matter as well as the great expense and delays which the petitioner has encountered in its effort to secure a just and fair adjudication of its claim. In the case of *Stone et al. Trustees v. Thomas W. White, Former Collector of Internal Revenue*, 301 U.S. 532; 57 S. Ct. 851, 852, Mr. Justice Stone said:

“The action, brought to recover a tax erroneously paid, although an action at law, is equitable in its function. . . .

“Its use to recover upon rights equitable in nature to avoid unjust enrichment by the defendant at the expense of the plaintiff, and its control in every case by equitable principles, established by Lord Mansfield in *Moses v. Macferlan*, 2 Burr, 1005 (K. B. 1750), have long been recognized in this Court. . . .”

For all of the foregoing reasons, it is respectfully submitted therefore, that the petition for certiorari in these cases should be granted.

Respectfully submitted,

O. WALKER TAYLOR,

Attorney for Petitioner.

APPENDIX.

THE STATUTE INVOLVED.

Revenue Act of 1918 (40 Stat. 1057-1060):

"Sec. 203. That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income."

THE REGULATIONS INVOLVED.

Regulations 45 (1920 Edition):

"Art. 1582. *Valuation of inventories.* . . . Inventories must be valued at (a) cost or (b) cost or market, as defined in Article 1584 as amended, whichever is lower. (See articles 1585 for inventories by dealers in securities.) Whichever basis is adopted must be applied consistently to the entire inventory. A taxpayer may, regardless of his past practice, adopt the basis of 'cost or market, whichever is lower', for his 1920 inventory, provided a disclosure of the fact and that it represents a change is made in return. Thereafter changes can be made only after permission is secured from the Commissioner. Inventories should be recorded in a legible manner, properly computed and summarized, and should be preserved as a part of the accounting records of the taxpayer. Goods taken in the inventory which have been so intermingled that they can not be identified with specific invoices will be deemed to be the goods most recently purchased."

"Art. 1584. *Inventories at market.* . . . Under ordinary circumstances, 'market' means the current bid price pre-

vailing at the date of the inventory for the particular merchandise in the volume in which ordinarily purchased by the taxpayer, and is applicable in the cases (a) of goods purchased and on hand, and (b) of basic elements of cost (materials, labor and burden) in goods in process of manufacture and in finished goods on hand; exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts at fixed prices entered into before the date of the inventory, which goods must be inventoried at cost. Where no open market quotations are available, the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available such as specific transactions in reasonable volume entered into in good faith, or compensation paid for cancellation of contracts for purchase commitments. Where, owing to abnormal conditions, the taxpayer has regularly sold such merchandise at prices lower than the current bid price as above, defined, the inventory may be valued at such prices, and the correctness of such prices will be determined by reference to the actual sales of the taxpayer for a reasonable period before and after the date of the inventory. Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market and the penalties prescribed for filing false and fraudulent returns may be asserted. Goods in process of manufacture may be valued for purposes of the inventory on the lowest of the following bases: (1) the replacement or reproduction cost prevailing at the rate of the inventory; or (2) the proper proportionate part of the actual finished cost; or, under abnormal conditions, (3) the proper proportionate part of the sales price of the finished product, account being taken in all cases of the proportionate part of the total cost of basic elements (materials, labor and burden) represented in such goods in process of manufacture at the stages at which they are found on the date of the inventory. The in-

ventories of taxpayers on whatever basis taken will be subject to investigation by the Commissioner, and the taxpayer must satisfy the Commissioner of the correctness of the prices adopted. He must be prepared to show both the cost and the market price of each article included in the inventory. It is recognized that in the latter part of 1918, by reason among other things of governmental control not having been relinquished, conditions were abnormal and in many commodities there was no such scale of trading as to establish a free market. In such case, when a market was established during the succeeding year, a claim may be filed for any loss sustained in accordance with the provisions of Section 214(a) (12) or Section 234(a) (14) of the statute. See Articles 261-268."





SEP 10 1940

CHARLES ELMORE CROPLEY
CLERK

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1939.

Nos. 130, 131.

WILLARD MANUFACTURING COMPANY,
Petitioner,

v.

J. E. KENNEDY, Former Collector,

and

WILLARD MANUFACTURING COMPANY,
Petitioner,

v.

ROBERT W. McCUEN, Collector.

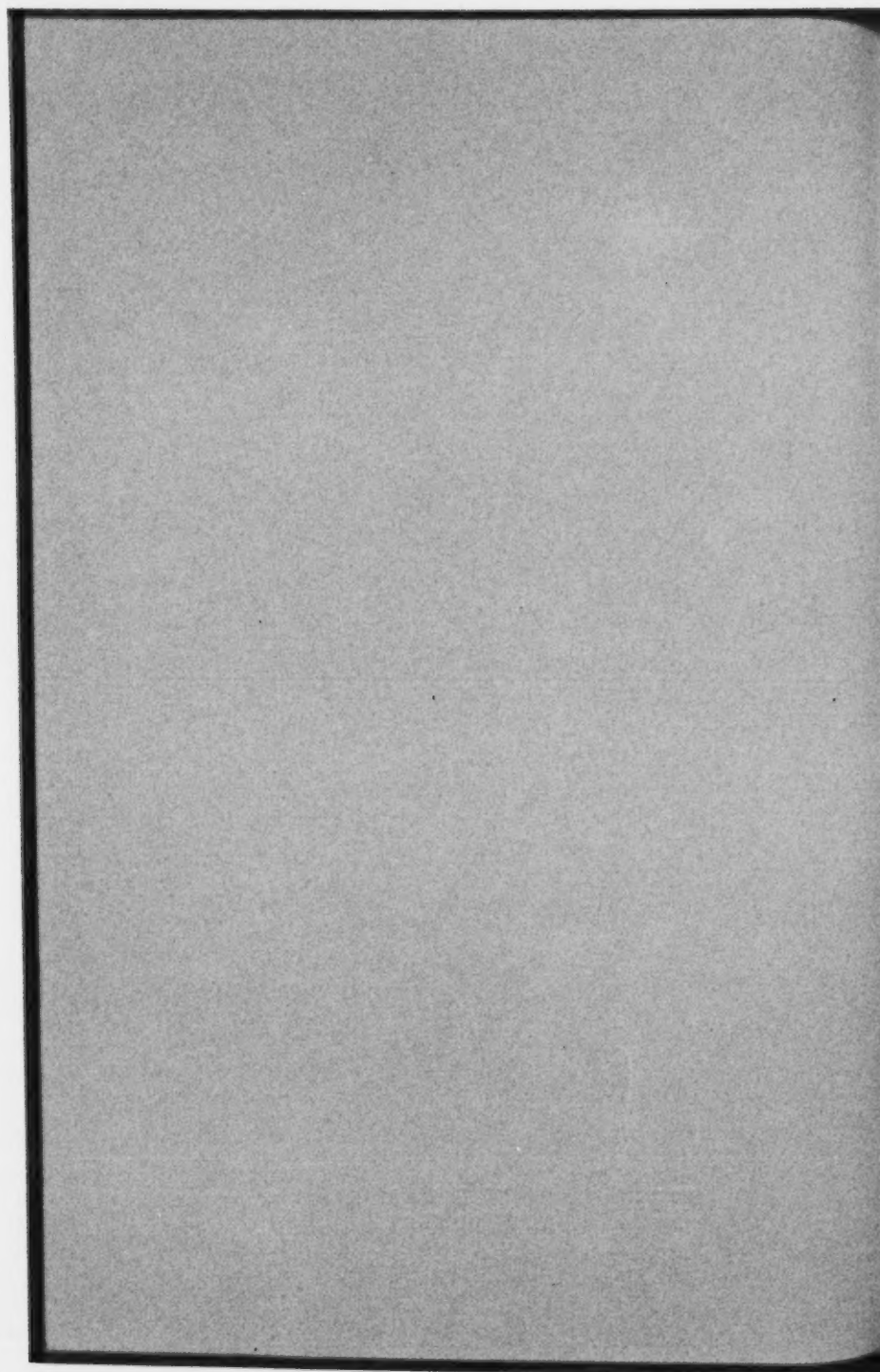
PETITION FOR WRITS OF CERTIORARI TO THE CIRCUIT
COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITIONER'S BRIEF IN REPLY.

O. WALKER TAYLOR,

11 Beacon Street, Boston, Massachusetts,

Attorney for Petitioner.



**In the
Supreme Court of the United States.**

OCTOBER TERM, 1940.

Nos. 130, 131.

**WILLARD MANUFACTURING COMPANY,
PETITIONER,**

v.

J. E. KENNEDY, FORMER COLLECTOR,

AND

**WILLARD MANUFACTURING COMPANY,
PETITIONER,**

v.

ROBERT W. McCUEN, COLLECTOR.

**PETITION FOR WRITS OF CERTIORARI TO THE CIRCUIT COURT OF
APPEALS FOR THE SECOND CIRCUIT.**

PETITIONER'S BRIEF IN REPLY.

*To The Honorable, The Chief Justice and the Associate
Justices of the Supreme Court of The United States.*

By way of reply to the brief of the respondents in opposition, the petitioner begs leave to call the attention of the Court to two matters:

First: One page 5 of the brief of the respondents in opposition the following statement is made:

"Petitioner asserts that the evidence supports the district court (Pet. 8-10). Petitioner has omitted, however, to certify to this Court the exhibits, including its tax returns for 1920 and prior years, which were before the circuit court of appeals and on which it made its decision. Hence there is no opportunity for adequate consideration of this question by this Court."

Immediately after the Circuit Court of Appeals had rendered its decision in these cases the Clerk of that Court returned all of the exhibits to the Clerk of the District Court at Burlington, Vermont. The petitioner thereupon requested the Clerk of the District Court to forward the exhibits in order that they may be submitted with the petition for certiorari if such should appear to be necessary. On May 8, 1940, the following letter was received from the Clerk of the District Court:

"DEPARTMENT OF JUSTICE

UNITED STATES DISTRICT COURT
Office Of The Clerk
District of Vermont

Burlington, Vermont,
May 8, 1940.

"O. Walker Taylor, Esq., Attorney at Law, 11 Beacon Street, Boston, Mass.

Dear Sir:

"I have your letter of May 7, requesting that the exhibits in the Willard Manufacturing Company cases against Kennedy and McCuen be sent to you.

The practice in this District is for the parties to retain control of their own exhibits.

Accordingly upon receipt of your request I have examined a package of exhibits in these cases which I

received from the Clerk of the Circuit Court of Appeals several days ago and have today delivered to the United States Attorney, Joseph A. McNamara, Burlington, Vermont, the defendant's exhibits in these cases and am sending to you the plaintiff's exhibits by railway express.

The exhibits being sent you are plaintiff's exhibits 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14 and 15.

With best wishes, I am

Sincerely,

/s/ AUSTIN H. KERIN
Clerk."

When the petition and printed record were filed with the Clerk of the Supreme Court it was not thought that all of the exhibits were necessary for the consideration of the petition for certiorari by this Court. Since the Government has raised the question, however, the petitioner is filing herewith the plaintiff's fifteen (15) exhibits mentioned above and counsel for the respondents have been and are hereby requested to file the defendants' exhibits with the Clerk of this Court before September 15, 1940 when, as we understand, the petition for certiorari and briefs are to be submitted to the Court. A complete list of the exhibits is presented in the table of contents of the record. The petitioner's fifteen exhibits herewith presented are the originals presented in the District Court as shown by the markings of the Clerk of that Court.

Second: On pages 6 and 7 of the brief of the respondents in opposition the following statement is made:

"Finally, this question arises in this case only upon acceptance of petitioner's contention that its 1920 return was at cost or market, whichever is lower, and that contention is not properly before the Court and, if it were, would present no question of general importance."

It is clearly obvious that the question of whether or not the petitioner's 1920 return was made on the basis of cost or market, whichever is lower is properly before this Court. The respondents themselves present that question on page 2 of the brief in opposition. The District Court not only found but rendered a separate decision on this question (R. pp. 33 and 34) as follows:

"The decision is that the plaintiff inventoried its merchandise August 31, 1920, 'at cost or market, whichever was lower', . . . 'as it had done in prior years'. The defendants except to this decision, for it says there was no evidence that the plaintiff had inventoried its merchandise at cost or market, whichever was lower, in 1920 or in prior years."

The fact that the Circuit Court of Appeals overruled this decision of the District Court is the strongest reason why the petitioner is appealing to this Honorable Court for a hearing on the question, which, contrary to the statement of the respondents, is of some general importance because it is most unusual for a Circuit Court of Appeals to overrule such a strong finding and ruling on matters of fact when made by the trial Court.

CONCLUSION.

For these and other reasons, therefore, it is respectfully submitted (1) that the grounds stated by the respondents in opposition to the allowance of certiorari in these cases are untenable and (2) that the petition for certiorari should be allowed for all of the reasons stated in the petitioner's brief.

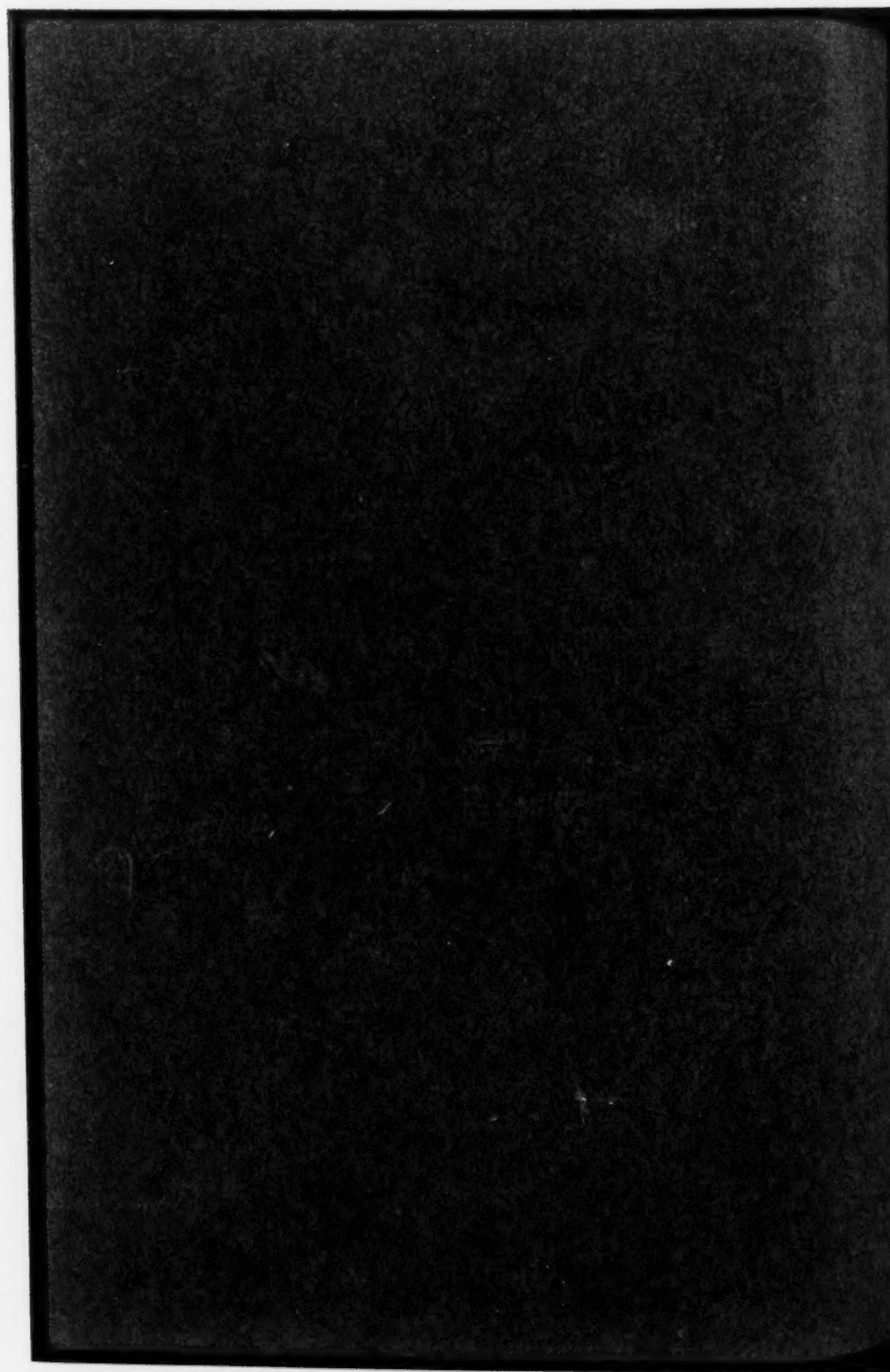
Respectfully submitted,

O. WALKER TAYLOR,
Attorney for Petitioner.





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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 130

WILLARD MANUFACTURING COMPANY, PETITIONER

v.

J. E. KENNEDY, FORMER COLLECTOR

No. 131

WILLARD MANUFACTURING COMPANY, PETITIONER

v.

ROBERT W. McCUEN, COLLECTOR

*ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE SECOND
CIRCUIT*

BRIEF FOR THE RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the district court (R. 28-33) was not reported. The opinion of the circuit court of appeals (R. 229) is reported in 109 F. 2d 83.

JURISDICTION

The judgment of the court below was entered February 10, 1940, in each of the constituent cases

separately (R. 235-236). A Justice of this Court extended the time for filing a petition for certiorari for 60 days from April 22, 1940 (R. 237). The petition was filed June 6, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether petitioner in its 1920 tax return valued its inventory at "cost or market, whichever is lower," and, if so, whether in the circumstances of this case petitioner was entitled to value its inventory on that basis.

2. Whether the evidence supports the concurrent findings of the courts below that the market value of petitioner's inventory was not lower than the value employed for tax computation.

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and regulations are set out in the Appendix.

STATEMENT

Petitioner, a manufacturer of cotton clothing, brought these two suits, which were consolidated for trial, to recover a claimed overpayment of income and excess profit taxes for petitioner's fiscal year ending August 31, 1920. Petitioner's declarations assert that petitioner valued its inventory as of August 31, 1920, "at cost or market, whichever is

lower," and that the valuation was excessive, because more than market. (R. 5, 8.)

The district court accepted petitioner's assertion that it valued its inventory at "cost or market, whichever is lower," but it found that the market value was not lower than the value employed in computing the tax, and therefore denied recovery (R. 29-33).

The circuit court of appeals affirmed. It held that petitioner, in its 1920 return, had valued its inventory at "cost", and not at "cost or market, whichever is lower", and that petitioner was not entitled to value its inventory on the latter basis. Further, it affirmed the finding of the district court that the market value of the inventory on August 31, 1920, was not lower than the value on which petitioner's tax was computed.

ARGUMENT

Originally in tax computation only cost was recognized as the basis for inventories. In December, 1917, the Treasury Department ruled that a taxpayer might use either (a) cost or (b) cost or market price, whichever is lower. T. D. 2609, 19 Treas. Dec. Int. Rev. 401. Accordingly Regulations 45 (1920 edition), Article 1582, provided:

* * * A taxpayer may, regardless of his past practice, adopt the basis of "cost or market whichever is lower", for his 1920 inventory, provided a disclosure of the fact and that it represents a change is made in

the return. Thereafter changes can be made only after permission is secured from the Commissioner. * * *¹

1. Petitioner's 1920 return stated that its inventories were priced on the basis of cost,² and thus made no disclosure of a change to a "cost or market, whichever is lower" basis, as was provided for in Regulations 45, Article 1582. Petitioner asserts, however, that its inventory was in fact taken on the basis of cost or market, whichever is lower, and that it was not necessary under the regulations for it to so disclose in its return in order for it to be entitled to use that basis, firstly, because it had employed the cost or market, whichever is lower, basis in its prior returns, so that its use represented no change, and, secondly, and alternatively, because the regulation was adopted after its return was filed.

¹ Regulations 45, article 1582, is set out in full in the Appendix, *infra*, p. 9. See also T. D. 3296, 24 Treas. Dec. Int. Rev. 531.

Section 203 of the Revenue Act of 1918, c. 18, 40 Stat. 1057, set out *infra*, p. 8, provides that when the use of inventories is necessary in order to determine income, inventories shall be taken "upon such basis as the Commissioner, with the approval of the Secretary, may prescribe" as conforming to the best accounting practice and as most clearly reflecting the income.

² The circuit court of appeals so stated in its opinion (R. 231) and petitioner so concedes (Pet. 9). Petitioner's 1920 tax return was put in evidence (R. 39) and was before the circuit court of appeals, but petitioner omitted to have the exhibits certified to this Court.

The district court upheld petitioner's contention that in its 1920 return petitioner inventoried its merchandise at "'cost or market', whichever was lower, * * * as it had done in prior years" (R. 29, 33-34). The circuit court of appeals held that the record did not support the district court's finding in this respect (R. 231). It stated that the 1920 return was based on cost, and that cost was apparently the basis used in petitioner's returns for the three preceding years (R. 231).

Petitioner asserts that the evidence supports the district court (Pet. 8-10). Petitioner has omitted, however, to certify to this Court the exhibits, including its tax returns for 1920 and prior years, which were before the circuit court of appeals and on which it made its decision. Hence there is no opportunity for adequate consideration of this question by this Court.³

Moreover the evidence on which petitioner relies relates wholly to its 1920 return, and in no way goes to establish that its prior returns were on the basis

³ This is well illustrated by the evidence on which petitioner relies (Pet. 8-9). All of the cited evidence (R. 43, 61, 79) is discussion or explanation of petitioner's original inventory, from which the inventory valuation in its 1920 tax return was taken. The original inventory was in evidence (Exhibit 10, admitted R. 69), but it is not before this Court. It was the Government's position below, evidently accepted by the court, that the inventory itself showed that the prices were at cost and not at market value. If so, it was plainly proper for the court below to disregard the testimony to the contrary.

of cost or market, whichever was lower. Apparently so recognizing, petitioner next asserts (Pet. 10-12) that even if its returns before 1920 were on a cost basis, it was not necessary for its 1920 return to disclose that it was on a new basis because the return was filed before promulgation of Regulations 45, Article 1582, requiring disclosure of a change of basis.

The decisions cited by petitioner in this connection (*Howard Company v. Commissioner*, 15 B. T. A. 1096; *Peck & Hills Furniture Co. v. Commissioner*, 16 B. T. A. 1008) hold that a taxpayer who filed a return on a cost basis before the regulation was issued was entitled thereafter to file an amended return changing to a basis of cost or market, whichever is lower. Petitioner never sought to amend its return; its claim as to cost or market valuation was first advanced in its refund claim filed in 1926. These decisions permitting the taxpayer to amend to take advantage of the regulation do not support petitioner's claim to ignore the regulation. Proper tax accounting practice would not, even in the absence of the regulation, have permitted petitioner to alter the basis of its tax returns without so disclosing.

Finally, this question arises in this case only upon acceptance of petitioner's contention that its 1920 return was at cost or market, whichever is lower, and that contention is not properly before

the Court and, if it were, would present no question of general importance.

2. The district court, although it accepted petitioner's other contentions, denied recovery because it found that the market value of petitioner's inventory on August 31, 1920, was not lower than the value employed in computing petitioner's tax (R. 28-33). The circuit court of appeals sustained this finding as supported by evidence and stated that this ground was alone sufficient to sustain its decision against petitioner (R. 233). This question is wholly one of fact and, both courts below having decided it against petitioner, there is no occasion for this Court to review it.

CONCLUSION

It is respectfully submitted that the petition should be denied.

FRANCIS BIDDLE,
Solicitor General.

SAMUEL O. CLARK, Jr.,
Assistant Attorney General.

SEWALL KEY,

J. LOUIS MONARCH,

WM. B. WALDC,

Special Assistants to the Attorney General.

THOMAS E. HARRIS,
Attorney.

JUNE, 1940.

APPENDIX

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060:

SEC. 203. That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

Treasury Regulations 45 (1920 ed.):

ART. 1581. *Need of inventories.*—In order to reflect the net income correctly, inventories at the beginning and ending of each year are necessary in every case in which the production, purchase or sale of merchandise is an income-producing factor. The inventory should include raw materials and supplies on hand that have been acquired for sale, consumption or use in productive processes, together with all finished or partly finished goods. Title to the merchandise included in the inventory should be vested in the taxpayer and goods merely ordered for future delivery and for which no transfer of title has been effected should be excluded. The inventory should include merchandise sold but not shipped to the customer at the date of the inventory, together with any merchandise out upon consignment, but if such goods have been included in the sales of

the taxable year they should not be taken in the inventory. It should also include merchandise purchased, although not actually received, to which title has passed to the purchaser. In this regard care should be exercised to take into the accounts all invoices or other charges in respect of merchandise properly included in the inventory, but which is in transit or for other reasons has not been reduced to physical possession.

ART. 1582. *Valuation of inventories.*—Inventories must be valued at (a) cost or (b) cost or market, as defined in article 1584 as amended, whichever is lower. (See article 1585 for inventories by dealers in securities.) Whichever basis is adopted must be applied consistently to the entire inventory. A taxpayer may, regardless of his past practice, adopt the basis of "cost or market whichever is lower", for his 1920 inventory, provided a disclosure of the fact and that it represents a change is made in the return. Thereafter changes can be made only after permission is secured from the Commissioner. Inventories should be recorded in a legible manner, properly computed and summarized, and should be preserved as a part of the accounting records of the taxpayer. Goods taken in the inventory which have been so intermingled that they can not be identified with specific invoices will be deemed to be the goods most recently purchased.

ART. 1584. *Inventories at market.*—Under ordinary circumstances, "market" means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which ordinarily purchased by the taxpayer, and is applicable in the cases (a) of goods purchased and on

hand, and (b) of basic elements of cost (materials, labor and burden) in goods in process of manufacture and in finished goods on hand; * * *. Where no open market quotations are available, the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available, such as specific transactions in reasonable volume entered into in good faith, or compensation paid for cancellation of contracts for purchase commitments. * * * Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market and the penalties prescribed for filing false and fraudulent returns may be asserted. * * * The inventories of taxpayers on whatever basis taken will be subject to investigation by the Commissioner, and the taxpayer must satisfy the Commissioner of the correctness of the prices adopted. He must be prepared to show both the cost and the market price of each article included in the inventory. * * *

